ffice of Chief Counsel
Internal Revenue Service

memorandum

CC:NER:OHI:CLE:TL-N-7902-98
CAFisher

date: MAR 12 1999

to: Chief, Examination Division, Ohio District
Charles Britten, Team Coordinator - Independence, Ohio
Jeffrey A. Myers, Engineer/Revenue Agent - Columbus, Ohio

from: Associate District Counsel, Ohio District
Cleveland, Ohio

subject: [redacted]
U.I.L. No. 168.20-02

This responds to your request for advice regarding the proper asset depreciation class life of certain equipment owned by [redacted] and leased to the [redacted]. Our advice is provided without prior coordination with the Office of Chief Counsel, pursuant to the 10-Day Post Review procedures of CCDM (35)3(19)4(4), as this issue involves primarily well-settled principles of law. We are required, however, to forward a copy of this memorandum to both the Assistant Chief Counsel (Field Service) and the Northeast Regional Office for review. Within 10 days after receipt, the Associate Chief Counsel is to advise this office as to whether it: 1) concurs with our opinion; 2) believes some modification is appropriate; or 3) needs additional information or time to evaluate our opinion. We will inform you of their response as soon as it is received.

Disclosure Statement

This document may contain confidential information subject to the attorney-client and deliberative process privileges, and may also have been prepared in anticipation of litigation. This document should not be disclosed to anyone outside the Service, including taxpayer(s) involved, and its use within the Service should be limited to those with a need to review the document in relation to the subject matter or case discussed herein. This document is also tax information of the instant taxpayer which is subject to section 6103 of the Internal Revenue Code[1].

Issue

Whether certain equipment owned by [redacted] and leased to the [redacted] is property described in Asset Class 30.21, 34.01, 37.11, or 37.12 of Rev. Proc. 87-56, 1987-2 C.B. 674.

Conclusion

The equipment at issue is used in the manufacture and assembly of motor vehicles, a category of property specifically addressed by Asset Classes 37.11 and 37.12. As such, we do not believe that the property at issue is property described in Asset Class 30.21 (Manufacture of Finished Products - Special Tool) or Asset Class 34.01 (Manufacture of Fabricated Metal Products - Special Tools), as the property is more particularly described in Asset Classes 37.11 or 37.12. Of these two classes, based upon the information provided, we believe that Asset Class 37.11 (Manufacture of Motor Vehicles) is more appropriate for the equipment at issue rather than Asset Class 37.12 (Manufacture of Motor Vehicles-Special Tools).

Facts

[redacted] is a subsidiary of [redacted]. [redacted] owned certain equipment (described below) which it leased under two separate lease agreements to the [redacted], for use at [redacted]'s [redacted]. The leases are generally referred to as the [redacted] lease, effective [redacted], and the [redacted] lease, effective [redacted]. [redacted] depreciated the leased equipment based upon a 3-year life, claiming that the equipment was property described in Asset Classes 30.21, 34.01, or 37.12. The examiner disagreed, contending that the property was actually within Asset Class 37.11, and was therefore depreciable over a 7-year period.

[redacted] provided a copy of two personal property reports prepared by [redacted] with respect to the equipment leased under the [redacted] and [redacted] leases. A copy of these reports is included herewith as Attachment A. Both [redacted] reports assert, but without providing any supporting

[1] All section references hereinafter, unless otherwise indicated, are to the Internal Revenue Code as in effect during the years in issue.

analysis, that the leased equipment is properly described in Asset Classes 30.21, 34.01, or 37.12. See Item 11 on p. 11 of the [redacted] reports. The equipment is described, however, as follows on page 9 of both [redacted] reports:

[redacted]

[redacted]

Attached to both [redacted] reports is a schedule of what appears to be individual items of equipment, presumably includible in either the [redacted] or [redacted] categories of equipment.

Analysis

The examiner contends that Asset Class 37.12 property description does not include property which is leased to another. In particular, Asset Class 37.12 provides, in part, that it:

> [i]ncludes assets defined as special tools, such as jigs, dies, fixtures, molds, patterns, gauges, and specialty transfer and shipping devices, <u>owned by manufacturers of finished motor</u> vehicles and <u>used</u> in qualified activities as defined in class 37.11.

Emphasis supplied. The examiner contends that the property in issue does not fit the above description because it is not "owned by a manufacturer" of a finished motor vehicle, i.e., it is owned by the lessor, [redacted]. [redacted] argues that this interpretation is in conflict with Treas. Reg. Sec. 1.167(a)-11(e)(3)(iii) which provides, in part:

> In the case of a lessor of property, unless there is an asset guideline class in effect for lessors of such property, the asset guideline class for such property shall be determined as if the property were owned by the lessee. However, in the case of an asset guideline class based upon the type of property (such as trucks or railroad cars) as distinguished from the activity in which used, the property shall be classified without regard to the activity of the lessee.

In response, the examiner compares Asset Class 37.12, to other asset classes, which, like Asset Class 37.12, applies to special tools used in the manufacture of some product. The examiner notes that these other comparable "special tools" asset classes, i.e., Asset Classes 32.11, 33.21, 34.01, and 37.33, are similarly worded to Asset Class 37.12, except for the fact that, unlike Asset Class 37.12, these other comparable asset classes do not require that the asset be "owned by the manufacturer." (these asset classes only require that the special tool be <u>used</u> in the manufacture of the particular product - and thus arguably encompasses leased equipment). We agree that this difference between the otherwise comparable special tool asset classes and Asset Class 37.12 must have a reason or purpose. The examiner argues (we believe persuasively) that the more restrictive language of Asset Class 37.12 is plain on its face, and that it is intended to limit the scope of its application to assets which are <u>owned</u>, and not leased, by manufacturers of motor vehicles.

We believe that the Commissioner's regulations, revenue rulings, revenue procedures and other promulgations are to be understood as being in harmony with each other. If a potential conflict arises between authorities then it is necessary to interpret the authorities so as to eliminate the conflict. Clearly, the language of Asset Class 37.12 and Treas. Reg. Sec. 1.167(a)-11(e)(3)(iii) present a potential conflict. We believe the apparent conflict should be resolved in favor of the view that the "owned by the manufacturer" language of Asset Class 37.12 was meant to except this class from the general rule of Treas. Reg. Sec. 1.167(a)-11(e)(3)(iii). We note that the language of the Treas. Reg. Sec. 1.167(a)-11(e)(3)(iii) regulation became final in 1971. T.D. 7128, 1971-2 CB 132. The language of Asset Class 37.12 (in its present form), however, first appeared subsequent to the issuance of the regulation. Rev. Proc. 73-25, 1973-2 C.B. 477. It must be assumed that the drafters of Rev. Proc. 73-25 were aware of Treas. Reg. Sec. 1.167(a)-11(e)(3)(iii) when they wrote the Asset Class 37.12 description. We believe that the drafter included the phrase "owned by the manufacturer" in Asset Class 37.12, but not the other comparable asset classes, for the purpose of providing an exception to the rule of Treas. Reg. Sec. 1.167(a)-11(e)(3)(iii), in the case of manufactures of motor vehicles.

As noted previously, Asset Class 37.12 applies to special tools used in the manufacture of motor vehicles. A special tool is defined therein as a tool that is:

> specifically designed for the production or processing of particular motor vehicle components and have no significant utilitarian value, and cannot be adapted to further or different use, after changes or improvements are made in the model design of the particular part produced by the special [tool].

Emphasis supplied. The [redacted] reports provide no analysis as to whether either the [redacted] or [redacted] met this requirement. In the absence thereof, we question whether the equipment in fact satisfies the above stated requirements. In particular, we question whether the [redacted], which serve to hold [redacted] in place while they are [redacted] are in fact incapable of adaptation to meet changes in model design. Similarly, we do not know whether the [redacted] can be modified to accommodate design changes. We do not know whether the [redacted] category of leased equipment is limited to just the [redacted] themselves, or whether it includes equipment which holds or services the [redacted] (which presumably could be adaptable to different [redacted] reflecting designing changes). Absent any analysis by [redacted] addressing this fundamental element of the Asset Class 37.12 definition, it cannot claim Asset Class 37.12 treatment with respect to either the [redacted] or the [redacted].

If you have any questions regarding the foregoing, please contact Chris Fisher at (216) 522-3380.

RICHARD E. TROGOLO
District Counsel

By: (SIGNED) CHRISTOPHER A. FISHER
CHRISTOPHER A. FISHER
Senior Attorney

Attachments:
Attachment A - [redacted] dated [redacted] and [redacted]